(12)

No. 608 609

Supreme Court of the United States.

OCTOBER TERM, 1944.

RAYTHEON PRODUCTION CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

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Subject Index.

	Page
PETITION	1
Opinions below	2
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	2
Specification of errors	6
Reasons for granting the writ	6
BRIEF	9
1. The decision below is in conflict with decisions in other Circuit Courts of Appeals	9
2. The decision below is in conflict with principles announced by this Court	10
Appendix	13

Table of Authorities Cited.

CASES.

Bowers v. Kerbaugh-Empire Co., 271 U.S. 170	11
Central R. Co. of New Jersey v. Commissioner, 79 Fed. (2d) 697	9
Doyle v. Mitchell Bros. Co., 247 U.S. 179	11
Edward N. Clark, 40 B.T.A. 333	10*n.*
Eisner v. Macomber, 252 U.S. 189	10
Farmers & Merchants Bank of Catlettsburg, Ky., v. Commissioner, 59 Fed. (2d) 912	9
Highland Farms Corporation, 42 B.T.A. 1309	10*n.*
Stratton's Independence v. Howbert, 231 U.S. 399	10
United States v. Safety Car Heating Co., 297 U.S. 88	11

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To the Honorable the Justices of the Supreme Court of the United States:

The petitioner, Raytheon Production Corporation, prays that a writ of certiorari may issue to review the decree of the Circuit Court of Appeals for the First Circuit entered July 28, 1944, in the case between the above-named parties, docketed therein as No. 3956. Said decree affirmed a decision of the Tax Court of the United States that an amount received in settlement of a damage suit under the federal anti-trust laws (charging damage to business good will through illegal licensing agreements) is taxable income in full in the absence of any showing of cost or other basis of the good will injured.

Opinions Below.

The findings and opinion of the Tax Court are reported in 1 T.C. 952, and printed in the Record, pp. 16-31. The opinion of the Circuit Court of Appeals is not yet officially reported (but see 1944 C.C.H. ¶ 9424). It is printed in the Record, pp. 139-148.

Jurisdiction.

This Court has jurisdiction to review said decree under U.S. Code, Title 28, Sec. 347.

This application is made within three months after the entry of such decree, as required by Section 350.

Question Presented.

Is an amount received in settlement of a suit under the federal anti-trust laws (charging tortious injury in damaging the valuable good will of a radio business but not involving accounting for any income or compensation for taking or conversion of any asset) income in the absence of showing of cost or other basis of the good will?

Statutes Involved.

The statute involved is the Revenue Act of 1936, Secs. 22, 111, 112, and 113. The relevant parts of these sections are set out in the appendix (*infra*, p. 13).

Statement.

The petitioner, Raytheon Production Corporation, came into existence as a result of a series of tax-free reorgan-

izations having no effect upon this case (R. 140). Like the court below, we will refer to any one of the original or successive companies as "Raytheon." The original Raytheon Company was a pioneer manufacturer of a rectifying tube which made possible the operation of radio receiving sets on alternating house current. In 1926 and 1927 it was doing a large and profitable business producing over half the rectifying tubes being used (R. 41). This business continued in 1928 on a diminishing scale. Earnings were: 1926, $450,000; 1927, $150,000; 1928, under $10,000 (R. 40, 41, 45). It was producing these tubes under patents of its own, free of any license fees. Radio Corporation of America (R.C.A.) had many patents covering most of the practical circuits used in radio sets (R. 42), and it developed a competitive tube which produced the same kind of rectification as Raytheon's.

Early in 1927 R.C.A. offered licenses to set manufacturers under its patents and cross-licensing agreements with General Electric Company, Westinghouse, and American Telephone & Telegraph Company. In the licensing agreement it incorporated "Clause 9," which provided that the licensee was required to buy its tubes from R.C.A. (R. 50). Clause 9 was held to be illegal in *Lord et al.* v. *Radio Corporation of America*, 24 Fed. (2d) 565 (D.C. Del.); affirmed, 28 Fed. (2d) 257 (C.C.A. 3); certiorari denied, 278 U.S. 648.

In 1928 practically all manufacturers were operating under R.C.A. licenses; and, as a consequence of the restriction in Clause 9, Raytheon was left with only replacement sales, which soon disappeared (R. 43). When Raytheon found it impossible to market its tubes in the early part of 1929, it obtained a license from R.C.A. to manufacture tubes on a royalty basis under the latter's patents. The license agreement contained a release of all claims of Raytheon against R.C.A. by reason of illegal acts of

the latter under Clause 9. But a side agreement provided that, if R.C.A. were to pay compensation to any other company on account of "Clause 9" damages, the right of Raytheon to assert its claim would be reinstated (R. 51). In 1931 R.C.A. admitted making cash settlements of other claims (R. 56). On December 14, 1931, suit was brought on the Raytheon claim against R.C.A. in the United States District Court for the District of Massachusetts for triple damages under the Sherman and Clayton Acts, *ad damnum* $15,000,000. The declaration alleged that the plaintiff had by 1926 created and then possessed a large and valuable good will in interstate commerce in rectifying tubes for radios and had a large and profitable established business therein; that the defendant conspired to destroy the business of the plaintiff and others by a monopoly of such business and did suppress and destroy the existing companies; that by the early part of 1928 the tube business of the plaintiff and its property and good will had been totally destroyed at a time when it had a present value in excess of $3,000,000 (R. 141). The suit was brought by the petitioner's predecessor, a Massachusetts corporation, but wholly for the benefit of the petitioner. The case came before this Court on a preliminary issue, 296 U.S. 459, and thereafter was referred to an auditor, who found that Clause 9 was not the cause of damage to the plaintiff but that the decline in the plaintiff's business was due to advancement in radio art and competition. He also found, however, that, if the plaintiff were entitled to recovery, the damages would be $1,000,000 (R. 142). A jury trial had been claimed, and it was open to the jury to come to different conclusions (R. 80, 83).[82] In the spring of 1938, just prior to the time for the commencement of the trial before a jury, officers of the Raytheon affiliated companies began negotiations for the settlement of the litigation with R.C.A. In the meantime, a suit brought by R.C.A. against

the petitioner for the non-payment of royalties resulted in a final judgment of $410,000 in favor of R.C.A. The parties finally agreed on the payment by R.C.A. of $410,000 in settlement of the anti-trust action, R.C.A. stating, however, that it wanted some of Raytheon's patent rights "thrown in" to R.C.A. (R. 60). Patent license rights were included in the settlement, but R.C.A. declined to allocate the amount paid. The agreement of settlement contained a general release of all claims between the parties (Exs. 19, 20, 24, R. 97-105).

The officers of the Raytheon companies testified that $60,000 of the $410,000 was the maximum worth of the patents (R. 68, 78). In the proceedings in the Tax Court the Commissioner admitted that the value of the patent rights did not exceed $60,000 (Answer, paragraph V B, R. 13).

The petitioner returned $60,000 of the $410,000 as income from the patent rights and treated the remaining $350,000 as a realization from a chose in action and not as taxable income. The Commissioner determined that the $350,000 constituted income on the following ground only: "It is the opinion of this office that the amount of $350,000 constitutes income under Sec. 22(a) of the Revenue Act of 1936. There exists no clear evidence of what the amount was paid for so that an accurate apportionment can be made as to a specific consideration for patent rights transferred to Radio Corporation of America and a consideration for damages. The amount of $350,000 has therefore been included in your taxable income" (R. 9).

The Tax Court sustained the Commissioner on the grounds (1) that in view of the general language in the instruments of release "We are unable to allocate any portion of the settlement to non-taxable capital recovery in the face of the presumption that the Commissioner's determination to the opposite effect is correct" (R. 27), and

(2): "If we assume that capital recovery is involved and contained in the compromise moneys, only that portion above basis may be left untaxed" (*sic*) (R. 29).

The Circuit Court of Appeals affirmed the Board of Tax Appeals, not on the ground that there was any lack of evidence that the $350,000 was received in settlement of the suit and constituted a return of capital involving no question of lost profits (R. 145), but on the ground: "Although the injured party may not be deriving a profit as a result of the damage suit itself, the conversion thereby of his property into cash is a realization of any gain made over the cost or other basis of the good will prior to the illegal interference" (R. 146). The court illustrated: "Thus A buys Blackacre for $5,000. It appreciates in value to $50,000. B tortiously destroys it by fire. A sues and recovers $50,000 tort damages from B. Although no gain was derived by A from the suit, his prior gain due to the appreciation in value of Blackacre is realized when it is turned into cash by the money damages" (R. ~~147~~ 146).

Specification of Errors.

The court erred in deciding that in this case any taxable income was derived or, in the case stated for illustration, would be derived under the Revenue Act of 1936.

Reasons for Granting the Writ.

The decision below is so unprecedented [1] and involves so important and basic a question of tax law, namely, whether an injured taxpayer is to be taxed upon compensation

[1] The Circuit Court of Appeals cites no decided case for its pronouncement. The texts cited and the cases discussed therein do not support the proposition.

in mitigation of damages inflicted upon it by a wrongdoer, that we submit it ought to be scrutinized and passed upon by this Court.

It has been decided in other Circuit Courts of Appeals that damages for injury to an intangible capital asset do not constitute income. The decision below is in conflict with these decisions.[2]

The decision is also in conflict with principles announced by this Court.[3]

The results that will flow from this decision in the ordinary case are such that the intention to produce them can hardly be imputed to Congress. Thus, suppose that at the same time A bought Blackacre, as stated in the court's illustration, X bought Whiteacre, which similarly appreciated in value to $50,000, and then voluntarily sold Whiteacre at that price. Or suppose governmental authorities, acting under the law of the land, took Whiteacre by eminent domain and paid X $50,000. In both such cases, where X parted with title to the land either voluntarily because he wanted to do so or where it was taken from him by laws enacted for the good of the community, there has occurred a sale or disposition of X's property that is taxed as capital gain. But in the case stated by the court, A, who has done no act and exercised no volition, has not been affected by any action that is not illegal—has not, in fact, been involved in any sale or disposition of anything—has

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[2] *Farmers & Merchants Bank of Catlettsburg, Ky.*, v. *Commissioner*, 59 Fed. (2d) 913 (C.C.A. 6).
Central R. Co. of New Jersey v. *Commissioner*, 79 Fed. (2d) 697 (C.C.A. 3). These cases are discussed in the accompanying brief (pp. 9 and 10).

[3] *Eisner* v. *Macomber*, 252 U.S. 189.
Bowers v. *Kerbaugh-Empire Co.*, 271 U.S. 170.
United States v. *Safety Car Heating & Lighting Co.*, 297 U.S. 88.
These cases are discussed in the accompanying brief (pp. 10 and 11).

merely been compensated for an injury—is subject to tax upon 100% of $45,000. Is it conceivable that Congress, which provided in Section 117 for partial relief to the taxpayer in the case of the sale or disposition of capital assets and in Section 112 for complete relief in the case of involuntary conversions of capital assets would not have made provision for the taxpayer who recovered damages for injury inflicted upon him by a wrong-doer, if it had thought that such recovery would be treated as anything but diminution of a loss and might be taxed as *income?* Has not Congress assumed, rather, that the Circuit Court of Appeals decisions above referred to satisfactorily stated the law? [4]

Furthermore, it must be remembered that the taxpayer is not enriched by the damages. He is merely compensated for the injury he has wrongfully suffered. It is purely speculative whether the good will built up before the wrong would or would not eventually be sold or disposed of so as to produce revenue to the government.

We submit that the decision below is in conflict with the decisions of other Circuit Courts of Appeals, that there is reason to believe that it is in conflict with principles laid down by this Court, and that it involves an important and basic question of federal taxation. We urge that the writ issue to resolve such conflicts and to bring about an early authoritative decision by this Court of the important question involved.

Respectfully submitted,

EDWARD C. THAYER,

Attorney for the Petitioner.

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[4] Since the decision in the *Farmers & Merchants Bank of Catlettsburg, Ky.*, case, June 27, 1932, eleven revenue acts have been passed by Congress.